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TAGS: ECON EFIN PGOV PINR CH
SUBJECT: YANGTZE RIVER DELTA ECONOMIC INTEGRATION

REF: A. 06 SHANGHAI 7027

¶B. SHANGHAI 177

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¶1. (SBU) Summary: In a meeting on April 19, Shanghai scholars told visiting Embassy ECON M/C that local and central Government plans called for further integration of the Yangtze River Delta's (YRD) transportation and communications infrastructure and greater coordination of environmental controls. Shanghai Party Secretary Xi Jinping had the experience (as former Zhejiang Party Secretary) and political connections to spur implementation of YRD integration plans. China's central government lacked the macro-economic tools to stabilize and regulate stability of China's economy. China would be cautious on liberalizing its financial sector since Chinese financial institutions were not yet ready to compete with international firms. End summary.

¶2. (SBU) Visiting Beijing ECON M/C met with Shanghai Academy of Social Sciences (SASS) Executive Vice President Zuo Xuejin, SASS Economic Institution Director Chen Jiahai, and Shanghai Jiaotong University Antai Economic and Management College Professor Pan Yingli on April 19. These academics engaged in a lively discussion on China's financial services sector issues, economic integration of Shanghai and other YRD cities, and the political and economic ramifications of then newly-appointed Shanghai Party Secretary Xi Jinping.

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Integrating Transportation, Environment and Social Safety Net Policies
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¶3. (SBU) Note: The YRD comprises the triangular-shaped territory of Shanghai, southern Jiangsu and northern Zhejiang provinces

where China's Yangtze River empties into the East China Sea. Crisscrossed with canals for irrigation and transportation, the YRD historically was one of China's most agriculturally rich and densely-populated areas. In modern times, the YRD, together with the Pearl River Delta Region and the Beijing-Tianjin-Bohai Region has been one of China's three engines of economic growth. Currently the YRD, led by Shanghai, surpasses all other regions in terms of GDP according to statistics from the Chinese National Statistical Bureau. See Ref A, and previous, for other reports on the YRD. End note.

¶4. (SBU) SASS professor Chen Jiahai said that the National Development and Reform Committee's (NDRC) 11th Five Year Plan envisaged long-term development of the YRD. As defined by the central government, the sixteen major cities of the YRD were: (in Jiangsu Province) Nanjing, Suzhou, Wuxi, Changzhou, Zhengjiang, Nantong, Taizhou; (in Zhejiang Province) Hangzhou, Ningbo, Shaoxing, Yangzhou, Jiaxing, Huzhou, Zhoushan, Taizhou; and, Shanghai.

¶5. (SBU) Chen said that the plan called for integration and coordination in transportation, environment and communications. This would include such areas as airports, high-speed railway, ports, pollution mitigation and environmental control in the Yangtze River and Tai Lake, he said. The plan also called for an integrated social security system to allow for a more free-floating population within the YRD. Chen added that the Ministry of Transportation's plan should lead to a better integration of the road and water-borne transportation systems in Zhejiang, Jiangsu and Shanghai. He also noted that several cities in the much poorer and less-developed neighboring Anhui Province had also expressed interest in being considered part of the official YRD region.

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Shanghai Party Secretary Has Power to Spur YRD Integration

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¶6. (SBU) SASS Executive Vice President Zuo said that he, like other academics, was still taking the measure of Shanghai Party Secretary Xi Jinping. Zuo said that Xi's experience in

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Zhejiang, China's main locus of private enterprise, could lead to more development of the private (as opposed to state-owned) economy in Shanghai. He also said that Xi was expected to advocate strengthening YRD economic integration and cooperation and increasing the importance of the YRD region. Zuo noted that previous Shanghai leadership had been wary of too much YRD integration since this would have raised concerns from the central leadership of the formation of a rival power base. Xi's apparently strong political relations with President Hu Jintao meant that he would be able to propel the YRD's integration.

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China's Lacks Effective Macro-Economic Controls
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¶7. (SBU) Jiaotong University Antai Management College Professor Ms. Pan Yingli said that the central government remained concerned about opening up the financial services sector to foreign competition. The government was particularly concerned that China's excess liquidity problem could impact the stability of the Chinese economy. Foreign financial institutions that entered China would increase capital inflows, and further worsen China's liquidity problem. She said that the lessons from the Asia financial crisis in 1990s were still very fresh in the minds of Chinese government leaders.

¶8. (SBU) Pan believed that the People's Bank of China (PBOC) lacked effective tools to control China's overheated economy. Since April 2006, PBOC had hiked the required reserve ratio eight times, raised the interest rate three times, and repeatedly used open-market operations and window guidance to

choke off some of the bank lending and cool down the economy. None of these efforts had any effect. Pan opined that PBOC was increasingly unable to use interest rate hikes since it was also trying to limit overseas capital inflows. Higher interest rates would provide further incentives to foreign capital coming into China to speculate on the continued RMB appreciation. (Note: The official deposit interest rate in April was 2.79 percent, whereas the CPI in March was 3.3 percent so that the real interest rate (after tax and inflation) was approximately negative 1 percent.) Beijing ECON M/C responded that a free-floating, market-based foreign exchange rate would help alleviate the capital inflow problems and also give PBOC more ability to use macro-economic measures such as interest rates to control the economy.

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Chinese Financial Institutions Not Ready to Compete
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¶9. (SBU) Additionally, Chinese financial institutions were undergoing a reform process, but their existing systems and practices were not yet compatible with, and had failed to respond to, the globalization of the market. The central government believed that it needed to liberalize slowly to protect Chinese financial institutions from too much competition. Pan also noted that Chinese Securities Regulatory Commission (CSRC) was not yet able to provide supervision of the market. She said that the many recent stories about insider trading and price manipulation in the stock market demonstrated that the China Securities Regulatory Commission (CSRC) lacked effective enforcement tools. ECON M/C responded by noting the benefits that greater foreign participation in the financial services sector would bring, such as increased competition and product innovation, and improved management practices. He also noted that many of these benefits would likely contribute to improving the regulatory environment as well by introducing

global best practices in market supervision.

¶10. (SBU) One approach to develop China's corporate bond market, Pan said, would be for the Ministry of Commerce to allow foreign-invested companies in China to issue corporate bonds. This also would provide one mechanism to partially address China's excess liquidity problem. Pan also suggested that China should consider allowing foreign joint venture fund management companies to offer individualized investment, or discretionary fund management, plans for high net-worth Chinese since this would help Chinese domestic financial institutions learn advanced risk management and investment management skills.

Biographic Notes

¶11. (U) Zuo Xuejin: Born in October 1949, Zuo is the Executive Vice President of Shanghai Academy of Social Sciences and the President of the Academy's Institute of Economics. Zuo obtained his doctoral degree from the University of Pittsburg in USA and was Notestein Fellow of the American Population Council in 1989. His research area focuses on population economics, migration and urbanization, and employment and social security. Zuo has a number of publications including "China's Population and Employment", "Private Economy and Development in Middle and Western China", "Research on Shanghai's Health Care System Reform", and "Township Health Care System Reform: the Function of Government and Market". He is fluent in English.

¶12. (U) Chen Jiahai: Chen's research at the Shanghai Academy of Social Science Department focuses on trade, development, and regional economic development and reform policies. Chen wrote several academic books on the financial relationship between Shanghai and the Central government, the development policies of the Pudong New Area, and inter-provincial trade and economic relations. Chen was also involved in the drafting the academic version of the eleventh Shanghai Five-year Plan. Chen Jiahai

was born in 1951 and obtained a bachelors degree from Fudan University Department of Economics.

¶13. (U) Pan Yingli: Pan has been a professor at Shanghai Jiaotong University Antai Economic and Management College since ¶2005. Before that, Pan worked in East China Normal University's Finance Department. Pan serves as an advisor to the Shanghai government, and was reportedly the drafter of Shanghai's 11th Five-year Plan research project on building Shanghai into an international financial center. She is also Director of the China International Economics Association, Director of China International Finance Association Director, and a guest professor at Shanghai's Fudan University, East China Politics and Law University and Macao Science and Technology University.
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